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IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

TRINOVA CORPORATION,
Petitioner,
v.
STATE OF MICHIGAN,
Respondent.

On Writ of Certiorari to the Supreme Court of Michigan

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

INTRODUCTION

In our opening brief we urged that Michigan's use of the three-factor apportionment formula was theoretically unjustified as applied to the principal components (labor and capital) of its SBT tax base, which are site specific, and produced an unconstitutional result, mainly because of the inclusion of the sales factor in the apportionment formula. Respondent and its Amici devote most of their briefs to contesting the point that the value added by compensation and depreciation can be separately identified. Their principal argument on this score depends on characterizing the SBT as a tax on "unitary," "indivisible," "business activity," an argument that asks the Court to substitute labels for analysis and to disregard the language of the statute which carefully prescribes the components of what it is that Michigan is seeking to tax.

They also contend that the factors that contribute to *income*, and make it impossible to allocate a unitary business's income tax base—such as centralized management and purchasing, functional integration, and economies of scale—make it equally impossible to allocate a unitary business's production costs. But that argument, we shall demonstrate, is incorrect because it overlooks the fact that, even if such things as centralized management affect the total production costs incurred, they do not preclude precise identification of the amount of such costs or the place where they are incurred. We have conceded that these factors preclude precise identification of the place of one small piece—the business income—of Petitioner's (and everyone else's) tax base, so that this small piece can be constitutionally apportioned in some fair way. This leaves for decision the question whether this small tail may validly wag the much larger dog.

Respondent and Amici also seek to defend inclusion of the sales factor in the apportionment formula on the ground that value added does not exist until a sale occurs. We will show below, however, that when VAT is calculated by the additive method, whether the goods purchased are sold or remain in inventory, tax is levied as the value is added through the employment of labor or the use of capital.

Respondent and Amici also liken the SBT to other, valid taxes, proceeding on a theory of borrowed constitutionality, but this position also directs the Court away from the economic realities of the SBT.

We make these points in greater detail below. We also show that the Court's dismissal of *Armco Steel Corp. v. Department of Revenue*, 359 Mich. 430, 102 N.W.2d 522, *appeal dismissed*, 364 U.S. 337 (1960), should be irrelevant to the outcome here, and that neither Respondent nor Amici have rebutted our showing that the SBT is discriminatory.

I. THE COMPENSATION AND DEPRECIATION COMPONENTS OF THE SBT TAX BASE CAN BE IDENTIFIED AND ARE SITE-SPECIFIC

Respondent and Amici recognize that the justification for using an apportionment formula lies in the difficulty of delineating a tax base on a geographic basis. Hence they are at pains to characterize the SBT as taxing a base whose components cannot be separately identified. But their characterizations ask the Court to forego economic analysis, to ignore the language of the SBT as well as its practical effects, and instead to focus on various labels that once might have protected a state tax against constitutional challenge.[1]

A. Calling The SBT A Tax On Business Activity Cannot Save It

Both Respondent and Amici say repeatedly that the SBT is a tax on indivisible business activity, the components of which are "fused."[2] It follows, they say, that the components of the SBT tax base are as elusive to pinpoint geographically as the components of income under an income tax act. The supposed inability separately to identify, either by amount or location, the various elements of the tax base means that the tax base may be apportioned by the three-factor formula.

This argument draws conclusions from labels and looks past the economic facts that destroy it. The Act itself, while stating that it taxes "business activity," defines exactly what that term means by identifying precisely the individual components of the tax base. *See, e.g.*, §§ 3(3) and 9(1), Mich. Comp. Laws Ann. §§ 208.3(3)

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[1] The Court has rejected the approach in state tax cases "that focused primarily on the character of the privilege rather than the practical consequences of the tax." *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 294-295 (1987).

[2] Resp. Br. 29; Amici Br. *passim* (the expression "business activity" appears 31 times in the first 15 pages of Amici's brief).

and 208.9(1), for the definition of "business income" (the profit component); §§ 4(3) and 9(5), Mich. Comp. Laws Ann. §§ 208.4(3) and 208.9(5), for the definition of compensation (the labor component); and § 9(4)(c), Mich. Comp. Laws Ann. § 208.9(4)(c), for the definition of depreciation (the principal part of the capital component). Indeed, the salient characteristic of an additive method VAT, which is what the SBT is (*see* Resp. Br. at 10-11), is that it identifies the components of the tax base—and even allows their separate taxation.[3] The legislature knew before the Act was passed that production costs—labor and capital—would dominate the tax base of "business activity,"[4] and in fact we now know that compensation accounts for 77% of the tax base for all taxpayers (and labor and capital together for something on the order of 94%).[5]

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[3] The ABA Special Committee on Value-Added Tax made the point in its Fifth Report:

> The additive-method VAT permits legislative flexibility if it is desirable or necessary to provide special tax treatment for the employment of labor. Special treatment also may be granted by applying one tax rate to "compensation" and another tax rate to the other factors of production—interest, rent, and profit. In effect, under the additive-method VAT, the legislature may tax compensation and profits differently.

Evaluation Of An Additive-Method Value-Added Tax For Use In The United States, Fifth Report of the Special Committee on Value-Added Tax, A.B.A. Sec. of Taxation, 30 Tax Lawyer 565, 580 (1977) (footnote omitted).

[4] *See* Haughey, *The Economic Logic Of The Single Business Tax*, 22 Wayne L. Rev. 1017, 1021 (1976).

[5] Pet. Br. 39; *see also*, Taxation and Economic Policy Office, Michigan Department of Treasury, *Analysis of the Michigan Single Business Tax* 27, Table 4 (1985). This Table is reproduced in our opening brief, Pet. Br., App. 1a. It is also an economic reality, to which Respondent has stipulated, that compensation accounted for 102% of Petitioner's tax base. Pet. App. 54a, Stipulated Facts, ¶ 8.

Contrary to Amici's contention (Amici Br. 11), there is nothing "imaginary" or "theoretical" about what we have just said. We have, rather, described "the practical effect of [the] challenged tax," *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 443 (1980), and the "economic realities" on which the Court must decide the SBT's constitutionality. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Amici argue instead that the Court should disregard these practical realities and decide this case on the basis of their "theory" of the SBT—"that it is impossible to identify the 'value added' by isolated elements of a firm's business activity, a theory that makes formulary apportionment unavoidable." Amici Br. 13. But that supposed "theory" is at war with the economic facts. It is *not* impossible to identify the individual components of the tax base; on the contrary, the SBT identifies them *precisely* and, as the stipulated facts in this case show, the amount contributed to the tax base by each individual component can be calculated to the penny.[6]

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[6] Respondent ignores "economic realities" as well when, in the course of undertaking a rather superficial analysis, it observes that Petitioner had total gross receipts of approximately $391,000,000 during the tax year at issue and that Petitioner reported $221,000,000 (or 56.6%) of that amount as its total preapportioned tax base. Taking that data, Respondent then observes that since Petitioner realized gross receipts in Michigan of almost $104,000,000 in 1980, it therefore follows that $58,000,000 (56.6% of $104,000,000) reflects value added by Petitioner in Michigan. This leads to Respondent's absurd conclusion that Michigan "laid claim only to slightly more than one-third of this value added of $58,000,000 by apportioning $19,838,700—or approximately 33.71% of the value added contained in the products sold in Michigan." Resp. Br. 37-41. There is of course no logical basis, or record support, for concluding that the value added to its products by Petitioner is the same percentage of sales in every jurisdiction in which it does business or that sales bear any relevance whatsoever to the calculation of anything other than the typically modest profit component of an additive method VAT.

In short, whether the subject of the SBT is said to be "business activity," or "the privilege of doing business," [7] or "the complete range of entrepreneurial activities," [8] or even "value added," it is measured by—and thus it is a tax on—compensation, capital costs and, to a much lesser extent, profit.[9]

B. The Unitary Business Principle Adds Nothing To The Analysis

Respondent and Amici misplace their reliance on decisions of this Court upholding formulary apportionment of the income of unitary businesses.[10] The principal question in those cases was whether the income tax base of the taxpayer should include income from corporate affiliates (or operations) outside the taxing jurisdiction. That question does not arise here. There is no debate over the scope of Petitioner's business. The question that does arise is whether, whatever the tax base, the fact that Petitioner's business is unitary means that apportionment of its total SBT tax base is proper. The answer is no.

Respondent and Amici contend that the factors that contribute to income, and make it impossible to allocate a business's income tax base—such as centralized management and economies of scale—make it equally impos-

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[7] Resp. Br. 25.

[8] Amici Br. 11.

[9] "A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *State Taxation of Interstate Commerce*, 27 Tenn. L. Rev. 239, 242 (1960).

[10] *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. New Mexico Dep't of Taxation and Revenue*, 458 U.S. 354 (1982); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980).

sible to allocate a business's production costs. The argument is seductive in its simplicity but wrong.

Formulary apportionment in the context of taxing a unitary business under an income tax act is justified because it is not possible to pinpoint by geographical attribution the contributions to income resulting from centralized management, functional integration, and economies of scale—features typically found in unitary business enterprises. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 438 (1980). These features do indeed impact on the level of profit or loss of a unitary business enterprise. This we have always conceded; and we have no quarrel with the three-factor apportionment formula as applied to the profit component of an SBT taxpayer's tax base. A company in the oil business may have producing wells in one state, exploratory wells in another, a refinery in another, and retail sales forces in still others. The difficulty of geographically allocating the company's overall income or profit on a state by state basis warrants resort to apportionment.

However, while it is also true that these same features may have some impact on the efficiency of the taxpayer's use of its labor force or its plant, it is nevertheless true (a) that the labor and capital components can be precisely identified by *amount* and by the *place* where they added value, and (b) that the *measure* of the value added by the labor and capital cost components is what the taxpayer pays for them.[11]

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[11] By parity of reasoning, the efficient use of real or immobile personal property of a multi-state manufacturer may also be affected by the market, yet that would not justify apportionment of an ad valorem tax on such property, whose location would remain the same regardless of the efficiency of its use. *See also, Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981) ("the severance can occur in no other state" and "no other state can tax the severance," *quoting* 189 Mont. 191, 206, 615 P.2d 847, 855 (1980)).

For example, assume a "nonunitary business" and a "unitary business" engaged in competition with one another. Assume also, in connection with the production of a single unit, the following:

Identity of Item	Nonunitary Business	Unitary Business
Sale Price	$130.00	$130.00
Material Cost	30.00	28.00
Labor Cost	70.00	67.00
Capital Cost	20.00	19.00
Profit	$ 10.00	$ 16.00

Centralized management, functional integration, and economies of scale, we will assume, allow the unitary business to derive $6 more profit than the nonunitary business—attributable, in this example, to $2 less material cost, $3 less labor cost, and $1 less capital cost. These reduced costs are reflected in the profit component of a VAT tax base—the component that, concededly, may be subjected to three-factor formulary apportionment. However, the measure of the value added by the labor and capital components of both taxpayers is what the taxpayer paid for those items. With regard to the labor component, the measure of the value added remains $70 for the nonunitary business, $67 for the unitary business; and, for the capital component, the measure of the value added remains $20 for the nonunitary business and $19 for the unitary business.

Accordingly, Respondent and Amici are simply wrong to argue that just because Petitioner conducts a unitary business, the Due Process Clause allows apportionment of the total SBT tax base.[12]

[12] What is more, Respondent has publicly declared that the SBT does not incorporate the unitary method of calculation. *See*, Taxation and Economic Policy Office, Michigan Department of Treasury, *Analysis Of The Michigan Single Business Tax* (January, 1985), Appendix A at A8. So too have Michigan courts that have considered the question. *Wismer & Becker Contracting Engineers v. Mich. Dep't of Treasury*, 146 Mich. App. 690, 382 N.W.2d 505 (1985); and *W.R. Grace & Co. v. Mich. Dep't of Treasury*, 115 Mich. App. 69, 320 N.W.2d 62 (1982). Thus, Respondent is, at minimum, inconsistent in its application of the unitary business principle under the SBT.

In any event, even if it were so that any tax base of a unitary business was properly subject to some apportionment formula, that would not insulate the SBT from constitutional challenge since, as we have shown in our opening brief (Pet. Br. 32-37), application of the three-factor apportionment formula to Petitioner has produced a grossly distorted result. *Container Corp.*, 463 U.S. at 170. Moreover, as this Court has ruled:

> The only reason for allowing a state to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. The purpose is not to expose the heel of the system to a mortal dart, —not, in other words, to open to taxation what is not within the state.

Wallace v. Hines, 253 U.S. 66, 69 (1920).

The compensation Petitioner paid to its Ohio employees "is not within the state" of Michigan and is not open to taxation there. If Michigan enacted a tax statute that forthrightly imposed a tax on a multistate business's compensation, no one would suppose that the Due Process Clause would permit that tax base to be apportioned according to the three-factor formula used to apportion income. Indeed, Respondent has conceded that this is so.[13]

[13] In the Michigan Supreme Court Respondent acknowledged that a tax on compensation "would apply to a tax subject so inherently locale-specific as to require specific allocation." *See* Pet. 12. In this Court Respondent also noted that labor and capital costs "are capable of geographic accounting, are locale specific." Opp. Pet. 13.

A different constitutional result cannot be obtained simply by reducing the compensation component of the tax base from 100% (under a direct tax on compensation) to 77% (the average for all taxpayers under the SBT)[14] and asserting that it is Petitioner's "business activity" that is being taxed.

In sum, the SBT is measured by the components of the value added tax base the Act itself identifies. The major components, compensation and depreciation, can be sourced to the states in which they are incurred. That economic fact cannot be gainsaid by describing the SBT as a tax on indivisible business activity, or by invoking the unitary business principle, or by suggesting a relationship between the market and the amount of those costs incurred.[15]

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[14] *Analysis Of The Michigan Single Business Tax, supra* note 5.

[15] Respondent mistakenly relies on language, taken out of context from *Amerada Hess Corp. v. Director, Division of Taxation*, 109 S. Ct. 1617 (1989), that the "costs of a unitary business cannot be deemed confined to the locality in which they are incurred" to support its claim that the labor and capital cost components of the SBT cannot be geographically segregated. Like the other cases on which Respondent relies, *Amerada Hess* concerned apportionment of *net income* and thus has no necessary bearing on the apportionment of site-specific labor and capital components of a value added tax base like the SBT. Furthermore, the Court's comments in *Amerada Hess* were directed to the question whether New Jersey could deny the nation's major integrated oil companies a deduction for federal Windfall Profit Taxes in computing such net income. Since the taxpayers were concededly conducting a unitary business from well-head to gas pump, *id.* at 1621, their income was apportionable by New Jersey in any event, and the only issue was whether a particular cost of earning admittedly apportionable income had to be allowed as a deduction because the cost was allegedly incurred outside the state. Finding it "unnecessary" even to reach the critical question that divides the parties here, namely, whether particular elements of the tax base are "site-specific," *id.* at 1622 & 1622 n.7, the Court found that the costs of generating unitary income are *by definition* no less unitary than the income itself, *id.*, because "the resulting net figure is still a unitary one." *Id.* Thus, while *Amerada Hess* may indeed support apportionment of costs as well as revenues of a unitary busines in calculating an income tax base, the decision has little relevance to the question whether compensation and depreciation, the site-specific cost components of a value added tax base, can be geographically determined.

II. VALUE IS ADDED BEFORE SALES OCCUR

In further support of their "indivisibility" argument, and in defense of the SBT's inclusion of the sales factor in its apportionment formula, Respondent and Amici argue that there is no value added by the labor of a taxpayer's employees or by the consumption of its capital resources until a sale occurs. Resp. Br. 47-50; Amici Br. 15-20. There is no explanation of why that is so, and in fact it is not.

Under a VAT using the additive method, like the SBT, the value added by the labor component is *realized* when the taxpayer incurs the cost for the labor of its employees. The value added by the capital component is realized when the capital is consumed. As the ABA's Special Committee on Value-Added Tax observed: "When VAT is calculated by the additive method, whether the goods produced are sold or remain in inventory, tax is levied as the value is added. . . . In essence, the additive method accelerates tax liability. Prior to sale, a firm adds value through the employment of labor or the expenditure of funds for rent and interest. . . . [T]he profit component of the VAT base generally arises by virtue of the sale of goods or the rendition of services."[16]

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[16] *Evaluation Of An Additive-Method Value-Added Tax For Use In The United States*, Fifth Report of the Special Committee on Value-Added Tax, A.B.A. Sec. on Taxation, 30 Tax Lawyer 565, 568 & n.15.

If sales occur in a later tax period than labor payments and capital consumption, the timing of tax reporting will be different under the addition and subtraction methods. The addition method will realize and recognize value added when labor is paid and capital

A concrete example may be useful. Assume that, in the manufacture of its product, a taxpayer purchases raw materials for $3, incurs labor and capital costs of $12 and $2, respectively, and sells at $18, for a $1 profit. If during the tax year 100 units are manufactured but 50 sold, the tax base of an additive type VAT will consist of $50 profit, $1200 compensation, and $200 capital—even though $600 of the compensation and $100 of the capital costs are attributable to goods that sit on the inventory shelf.

Nor are sales required in order to determine the *amount* of the value added by the labor and capital components of a value added tax. The measure of the value added by labor and capital, determined again at the point of realization, is the taxpayer's cost—what it paid in compensation for the services of its employees; what it paid in interest for use of borrowed capital; what it consumed of its plant in the form of depreciation.

Evidence that this is so may be found in the SBT itself. Thus, SBT § 9, Mich. Comp. Laws Ann. § 208.9 (West 1990), specifically describes the labor and capital components of value added in terms of what the taxpayer pays for those items. Sales impact only on the measure of the profit component of value added.

The Michigan Supreme Court has also observed that the measure of value added for labor and capital is what the taxpayer pays for same. That Court has noted:

> The value of the inputs used is measured by the cost to the producer of obtaining the use of those inputs. The value of the worker's labor is the wages the laborer is paid to produce the good. The value of the . . . capital is what the producer must pay . . . [for

consumed, whereas the subtraction method will defer recognition of those items for tax reporting purposes until the period in which the sale occurs.

> its] use . . . . And the profit is what keeps the producer-entrepreneur in business, which is measured by the difference between the cost of production and the receipts from sales.

Mobil Oil Corp. v. Mich. Dep't of Treasury, 422 Mich. 473, 493-494, 373 N.W.2d 730 (1985).

In sum, sales are required neither to *realize* value added by the labor and capital components of tax base nor to determine the measure or *amount* of the value added by the labor and capital cost components.

III. THE SBT CANNOT BORROW CONSTITUTIONALITY FROM OTHER TAXES

Respondent and Amici claim that in practical effect the SBT is like an income tax, or a sales tax, or a gross receipts tax, or halfway between a gross receipts tax and an income tax, or a "derivative" of a gross receipts tax. *E.g.*, Resp. Br. 15-16; Amici Br. 23. These comparisons are all meant to put the SBT in good company, but they cannot establish its innocence by association.

Respondent's placement of the SBT halfway between an income tax and a gross receipts tax leads to its argument that, since those taxes may be apportioned through some fair formulary method, the SBT should be as well. Resp. Br. 15-17. So far as we are aware, however, no gross receipts tax has ever been apportioned by the three-factor formula.[17] The same is true of sales taxes, to which Amici also compare the SBT. Amici Br. 23. The comparison to an income tax is equally unhelpful: income makes up 100% of the tax base of an income tax,

[17] The State of Washington is the only state with a broad based, business gross receipts tax. As to a business operating within and without the state, the tax requires actual allocation of receipts and, if that is infeasible, apportionment based on in-state versus out-of-state costs of production. *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987).

whereas it makes up about 6% of the SBT tax base. It is wholly appropriate to apportion the income component of the tax base, for the same reason that the three-factor formula has been accepted in many income tax cases, but Michigan may not constitutionally allocate to itself the bulk of the tax base that is identifiably located elsewhere simply because it is appropriate to apportion the little piece of the tax base that cannot accurately be identified with any particular location.[18]

Amici say that we champion a "wooden semanticism" because we have allegedly conceded that the SBT "would be immune from constitutional attack were it labeled a tax on gross receipts." Amici Br. 22, 25. We conceded no such thing. We said that Michigan could have imposed a *different tax*—a gross receipts tax—on Petitioner that would have yielded as much or more tax revenue as did the SBT. Pet. Br. 35-36. Amici challenge us for "asserting that the SBT cannot be validated by the availability of some alternative constitutional tax" (Amici Br. 23), but our assertion must be right. It cannot be the law that the test of one statute's constitutionality is whether it produces no more tax revenue than some other statute whose validity is unchallenged. *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

Amici's suggestion that *McLeod* is no longer good law is altogether wrong. It is still the law that an unconstitutional tax cannot be defended by showing that a different or even similar tax—one measured by a different tax base or imposed upon different taxpayers—could have been adopted, constitutionally, by the state. Many considerations enter into what kind of tax a state chooses to adopt. Aggregate tax collections may be different; taxpayers may pay different amounts. The validity of

[18] The comparison to an income tax is also inapt because, if Michigan had adopted an income tax, Petitioner would have paid no taxes at all since it incurred a loss for the year here at issue. *See*, Pet. Br. 14.

the tax a state has chosen to adopt must be determined by what the state has done and not by what it might have done.

IV. THE DISMISSAL IN ARMCO IS NOT CONTROLLING

Respondent and its Amici purport to find support for the constitutionality of the SBT in this Court's order, thirty years ago, summarily dismissing a challenge to Michigan's former Business Activities Tax (BAT), which allegedly resembled the SBT "in all essential details." Resp. Br. 12-14; Amici Br. 21; *Armco Steel Corp. v. Department of Revenue*, 359 Mich. 430, 102 N.W.2d 522 (1960), *appeal dismissed*, 364 U.S. 337 (1960). Wholly apart from the little deference the Court gives to summary dispositions, *Ashland Oil, Inc. v. Rose*, —— U.S. ——, ——n * (Slip Op. at 4 n.*) (1990) (Per Curiam); *Caban v. Mohammed*, 441 U.S. 380, 390 n.9 (1979), examination of the questions raised in *Armco* demonstrates rather clearly that the decision in *Armco* has no bearing on the issues raised by Petitioner here.

The principal question that the appellant sought to raise in *Armco* was whether Michigan's BAT, which was measured by gross receipts less specified deductions and was apportioned by the standard three-factor income tax apportionment formula, should be characterized as an income tax or as a gross receipts tax. This Court had recently determined that a fairly apportioned net income tax could be imposed on a multistate business without constitutional objection, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), but it was still thought that a gross receipts tax on interstate commerce constituted a "direct" burden on interstate activity that violated the Commerce Clause. *Freeman v. Hewit*, 329 U.S. 249 (1946).[19] The Michigan Supreme

[19] It was not until 1977 in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), that the Court rejected the rule of *Freeman* that "a direct tax on interstate sales, even if fairly apportioned

Court, emphasizing throughout its opinion that the BAT is "not a gross receipts tax" (359 Mich. at 444, 102 N.W.2d at 560) "but an income tax" (359 Mich. at 449, 102 N.W.2d at 562),[20] found *Northwestern* "definitely controlling," 359 Mich. at 453, 102 N.W.2d at 564, and sustained the levy.

On appeal to this Court, the parties continued their debate over whether the BAT was a presumably constitutional tax on income from interstate commerce or a presumably unconstitutional tax on gross receipts from interstate commerce. Thus, the appellant characterized the BAT as a "direct" tax on gross receipts, arguing that a "state tax on gross receipts from interstate commerce is indistinguishable from a direct tax on that commerce." Jurisdictional Statement in *Armco*, at 14. The State responded that the BAT was an "income tax" and therefore "not a forbidden direct tax on interstate commerce." Motion to Dismiss or Affirm at 12. If one can reliably conclude anything from the Court's summary dismissal of the appeal, it is that the Court accepted the Michigan court's description of the BAT as a fairly apportioned income tax, which was clearly constitutional under *Northwestern*. It surely does not mean that the Court determined that a constitutional issue not even raised or discussed by the parties was unworthy of full consideration.

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and nondiscriminatory, was . . . unconstitutional per se." *Id.* at 280.

[20] The Michigan court observed that the title of the act adopting the BAT "announces it to be 'An act to provide for the raising of additional public revenue by prescribing certain *specific taxes on income* * * *.'" 359 Mich. at 443, 102 N.W.2d at 559 (emphasis in original); that cases like *Freeman* involved "direct taxes on gross receipts from interstate commerce" that "are forbidden to the States" and not "as here, an apportioned adjusted receipts or income tax," 359 Mich. at 447, 102 N.W.2d at 561; and that the tax "is arrived at by imposing a rate and applying an apportionment formula to 'adjusted receipts' or 'income.'" 359 Mich. at 452, 102 N.W.2d at 564.

In the present case, by contrast, the critical question is not whether the SBT fits into the pigeonhole of an "indirect" income tax or a "direct" gross receipts tax on interstate commerce. *Complete Auto Transit* teaches that such labels are no longer controlling, and, in any event, Respondent concedes that "the SBT cannot be construed as a net income tax." Resp. Br. 15. Rather, the question is whether a tax—however denominated—that falls largely on labor and capital costs can pass constitutional muster when the lion's share of those costs are incurred outside the taxing state. There is nothing in the formal debate that dominated the *Armco* case to suggest that the Court ever gave this issue any thought, and it is therefore unreasonable to contend that the Court's dismissal of the appeal in *Armco* has any bearing here.

V. THE SBT DISCRIMINATES AGAINST OUT-OF-STATE TAXPAYERS

Neither Respondent nor Amici answer Petitioner's underlying claim of discrimination except to state that which is both true and irrelevant: a state may encourage economic activity. While that may be a valid objective for a state in structuring a tax, it may not do so in a discriminatory manner. Thus, this Court observed in *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988), that:

> The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce.* Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufactures does. (Emphasis in original).

Most of what is offered to substantiate Respondent's claim that the SBT does not discriminate against Petitioner or other out-of-state taxpayers is really no response at all. For instance, it is declared that evidence

of nondiscrimination is found in the three-factor formula itself. The fact that it does not contain a doubleweighted sales formula or that it does not delete one of the property, payroll, or sales factors from the formula is, as Respondent sees it, evidence of nondiscrimination. This response, of course, merely begs the ultimate question. As another example, Amici attempt to steer a course through those decisions that have addressed discriminatory state taxes—trying to distinguish the case presented here from those cases because the alleged discrimination here does not involve facially different tax rates, credits or exemptions. Amici's attempt on that score fails also, however, since the "practical operation" of the SBT discriminates against interstate commerce and that alone is all that need be demonstrated. *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 69 (1963).

Respondent attempts also to discredit Petitioner's example of discrimination (Pet. Br. 39-41) by claiming that it should not escape attention that the hypothetical Michigan business is also subject to Ohio's income tax. Resp. Br. 66-69. Respondent then proceeds to put together a rather complicated hypothetical scenario designed to demonstrate that the Michigan business will pay more tax to Michigan and Ohio than will the Ohio business. Of course, there is no record support for this proposition; and, even if there were, Respondent's example would not cure the discriminatory effect of the SBT. The discriminatory effect of the SBT is not ameliorated by demonstrating that the Michigan business pays more to both states in the aggregate than does the Ohio business.[21] If it is true, as we contend, that the SBT systematically reduces the tax bases of businesses located principally within the state that sell their products elsewhere, while systematically

[21] This is really no more than the reverse of the argument made by the taxpayer and rejected by the Court in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 277 n.12 (1978). *See also, Armco, Inc. v. Hardesty*, 467 U.S. 638, 644, 645 (1984).

increasing the tax bases of businesses located principally outside the state that sell their products in Michigan, it is irrelevant how the Michigan taxpayers may fare under tax statutes of other states.

CONCLUSION

The judgment of the Supreme Court of Michigan should be reversed.

Respectfully submitted,

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